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IN THE

Supreme Court of the United States

TERM, 1959

No. 226

S. B. BRINSON and
LEOTA L. BRINSON,

Petitioners

vs.

LAURIE W. TOMLINSON,
Director of Internal Revenue
for the District of Florida,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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THE FREE PRESS, TAMPA FLORIDA

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, S. B. BRINSON and LEOTA L. BRINSON, pray that a Writ of Certiorari issue to the United States Court of Appeals for the Fifth Circuit to review its two to one judgment and opinion entered on February 26, 1959, and order denying petition for rehearing entered on April 22, 1959, by that Court, thereby affirming a judgment for the respondent by the

United States District Court for the Southern District of Florida, Tampa Division, which was filed on May 21, 1958.

Opinions Delivered By Lower Court

The opinion of the United States District Court for the Southern District of Florida, Tampa Division in the above styled case is unofficially reported in 1958-1 U.S.T.C. ¶9405. See Appendix A.

The opinion of the United States Court of Appeals for the Fifth Circuit in the above styled case is officially reported in 264 F2d 30 (5th Cir. 1959). See Appendix B.

The denial of a petition for rehearing rendered without opinion by the United States Court of Appeals for the Fifth Circuit, Judge Cameron dissenting, has not been reported.

Jurisdiction of This Court

The judgment of the United States Court of Appeals for the Fifth Circuit sought to be reviewed was entered on February 26, 1959, whereunder the judgment of the United States District Court for the Southern District of Florida, entered May 21, 1958, was affirmed.

The date of entry by the United States Court of Appeals for the Fifth Circuit of an order denying your petitioners' Petition for Rehearing was April 22, 1959.

The statutory provisions believed to confer on this Court jurisdiction to review the judgment in question by Writ of Certiorari are 26 U.S.C. 7482(a) and 28 U.S.C. 1254(1).

Questions Presented For Review

1. Did the United States Court of Appeals and District Court below err in holding that the petitioners-taxpayers were not entitled to an income tax deduction for attorneys' fees paid for services rendered in successfully forestalling federal criminal tax fraud prosecution as an ordinary and necessary business expense?

2. Did the United States Court of Appeals and District Court below err in holding that the petitioners-taxpayers were not entitled to an income tax deduction for attorneys' fees paid for services rendered in successfully forestalling federal criminal tax fraud prosecution as an ordinary and necessary non-business expense?

3. As a result of the holdings in 1 and 2 above, did the United States Court of Appeals and the District Court below err in holding the petitioners-taxpayers could not recover judgment against respondent District Director of Internal Revenue in the United States District Court for the Southern District of Florida?

4. Did the United States Court of Appeals err in holding that the United States District Court for the Southern District of Florida did not abuse its discretion in denying a timely motion brought by petitioners to permit the taking of testimony to supplement a stipulation entered into between petitioners and respondent, which stipulation was relied upon by the Court of Appeals and District Court below in rendering their decisions?

5. Did the United States Court of Appeals err in refusing to remand this cause to the United States District Court below to allow the taking of testimony to supplement a stipulation entered into by petitioners and respondent?

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

The constitutional provisions, statutes and regulations involved herein are:

U. S. Constitution, Amendment VI.

"In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defense."

Internal Revenue Code of 1939.

"Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a), Revenue Act of 1942, c. 619, 56 Stat. 798]. *Expenses.*

(1) Trade or Business Expenses.

(A)—*In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes

of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

* * * * *

"(2) *Non-Trade or Non-Business Expenses.*— In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

* * * * *

[26 U.S.C. 1952 ed., Sec. 23.]

United States Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939.

"Sec. 39.23(a)-1. *Business Expenses.* — Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than subsection (a) of section 23. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provisions thereof. As to charitable contributions by corporations not deductible under section 23(a), see 39.22(a)-13. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. See 39.22(a)-5. Among the items included in business expenses are management expenses, commissions (but see 39.24(a)-2), labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely

in the pursuit of a trade or business (see 39.23(a)-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. * * * Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. As to items not deductible under any provisions of section 23, see section 24. * * *"

"Sec. 39.23(a)-15. *Nontrade or Nonbusiness Expenses.*—(a) Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a)(2) only upon the condition that:

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

"(2) It is an ordinary and necessary expense for either or both of the purposes stated in subparagraph (1) of this paragraph."

"(b) The term 'income' for the purpose of section 23(a)(2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income, but applies as well to gains from the disposition of property." * * *

"(c) Expenses, to be deductible under section 23 (a)(2) must be 'ordinary and necessary,' which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income."

"(d) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23(a)(1)(A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24." * * *

* * * *

"(k) * * * Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income."

STATEMENT OF THE CASE

Petitioners filed a timely joint income tax return for the calendar year 1952 (R. 1). As a result of review and audit of the petitioners' return, the Commissioner of Internal Revenue asserted a tax deficiency against petitioners (R. 1). Such determination was set forth in a letter from the Commissioner to the petitioners dated May 19, 1955. The asserted deficiency was occasioned by the Commissioner's disallowing a deduction of $22,920.10 claimed by the Brinson Construction Partnership in 1952. (R. 1-2). The disallowance of the deduction resulted in an increase in the partnership's net income attributable to petitioner, S. B. Brinson, in the amount of $11,460.05 and a deficiency of $6,712.87. (R. 2).

The principal amount of the asserted deficiency and interest thereon was paid by petitioners on June 6, 1955, and July 13, 1955, to Laurie W. Tomlinson, respondent, The Director of Internal Revenue for the District of Florida (R. 2).

Timely claims for refund were filed by petitioners on or about July 15, 1955. (R. 2).

Over six months elapsed after filing claims for refund without notification from respondent or the Commissioner that the claims had been allowed or disallowed. (R. 2).

Timely suit for refund of the tax paid plus interest and costs was instituted in the U. S. District Court for the Southern District of Florida by petitioners against respondent on January 23, 1946 (R. 2-3). Such suit was brought pursuant to the jurisdictional authority of c. 646, 62 Stat. 932, 28 U.S.C. 1340.

The District Court's Pre-Trial order, relying on pleadings (R. 3) formulated the following issue: (R. 3-4).

> "The third question presented, to be decided by the Court upon stipulation of facts agreed to by the parties, is whether the payment of $22,920.10 by the Brinson Construction Company, a partnership, as attorney fees, was an ordinary and necessary business expense of the partnership and deductible from gross income on the partnership's income tax return; or in the alternative, if it was not an ordinary and necessary business expense of the partnership, was it an ordinary and necessary non-business expense of the individual partners and deductible from gross income by each partner individually."

The $22,920.10 deduction in issue was paid by the Brinson Construction Partnership to the law firm of Mabry, Reaves, Carlton, Anderson, Fields and Ward of Tampa, Florida, for services rendered. (R. 6). Part of the work done was devoted to presentation to the Treasury Department of arguments which would justify the Government's declining to commence criminal tax fraud charges against one Chalmers M. Parker and petitioner, S. B. Brinson, the sole members of the partnership. (R. 6). Part of the services rendered was connected with the determination of civil tax liability of the partnership and the partners. (R. 6). As a result of such representation, criminal charges were withdrawn, no indictment was returned and civil tax liabilities were settled. (R. 6).

The petitioners asserted that the attorneys' fee paid was properly deductible as an ordinary and necessary business expense under the authority of Section 23(a)(1)(A) of the *Internal Revenue Code of 1939* (26 U.S.C. 1952 ed., Section 23) or as an ordinary and nec-

essary non-business expense under the authority of Section 23(a)(2) of the *Internal Revenue Code of 1939* (26 U.S.C. 1952 ed., Sec. 23). (R. 2, 3).

The facts surrounding the attorneys' fee issue herein related were set forth in a Stipulation of Facts (R. 4-6) prepared by counsel of parties in February 1957 (R. 10-11). On March 15, 1957, (R. 7) counsel for petitioners proposed the following supplemental stipulation:

> "All of the fraudulent acts of which plaintiff, S. B. Brinson, was accused arose out of the business activities of the partnership".

The Government refusing to stipulate further, petitioners' attorneys made a motion for an order permitting the taking of testimony to supplement the Stipulation of Facts on April 30, 1957. (R. 7). This motion was denied May 9, 1957. (R. 12).

Ten months later, on March 18, 1958 (R. 12) the District Court, trying without jury, adopted the original and unamended Stipulation of Facts (R. 4-6) as Findings of Facts (R. 12) and entered judgment against the petitioners-taxpayers on the attorneys' fee issue on May 21, 1958. (R. 12). See Appendix A.

On June 2, 1958, petitioners timely filed notice appeal. (R. 13).

On August 13, 1958, attorneys for petitioners and respondent entered into an Agreed Statement of the Case pursuant to Rule 76, *Federal Rules of Civil Procedure,* which was approved by the U.S. District Court (R. 16), and Certified by the Clerk of the Court (R. 17).

The Court of Appeals for the Fifth Circuit affirmed the judgment of the District Court on February 26, 1959, Circuit Judge Cameron dissenting. See Appendix B, setting forth opinion and dissent.

Your petitioners' Petition for Re-hearing was denied April 22, 1959, without opinion. Circuit Judge Cameron dissented.

ARGUMENT

Substantive Law

The principal substantive issues in this case involve whether a taxpayer is entitled to a deduction for legal fees paid to attorneys for dual services performed, to-wit: (1) determination of civil income tax liability of a partnership and its partners, and (2) presentation of arguments to the federal authorities as to why criminal tax fraud charges should not be brought against the partners. The record states (R. 6):

> "A part of the work done and services rendered by the law firm of Mabry, Reaves, Carlton, Anderson, Fields & Ward throughout the period covered by this Stipulation was devoted to presentation to the Government of the reasons and arguments which, in the opinion of the Taxpayer, would justify the Government's declining to commence criminal proceedings against Chalmers M. Parker and the Plaintiff, S. B. Brinson. A part of the services performed was in connection with the determination of the civil tax liability of the partnership and the partners. The law firm charged a fee of $22,500.00 which was paid by the partnership and deducted on its 1951 income tax return. This deduction was disallowed by the Commissioner which resulted in an increase of $22,500.00 in the partnership's taxable income, and an increase of $11,250.00 in Plaintiff's taxable income."

Determination of Civil Tax Liability. The deductibility of attorney's fees attributable to services performed in the determination of civil tax liability is clear under the *Internal Revenue Code of 1954* and the *Internal Revenue Code of 1939*. *Internal Revenue Code of 1954*, Section 212 (26 U.S.C. Sec. 212). *U. S. Treasury Regulations*, Section 1.212-1(1). *Internal Revenue Code of 1939*, Section 23(a) (26 U.S.C. 1952 ed. Sec. 23). *U. S. Treasury Regulations 118*, Section 39.23(a)-15 (k). Therefore, this problem is not raised as a proper subject of this petition beyond its connection with the other substantive issue: deductibility of fees paid attorneys for successfully preventing criminal tax fraud indictment and prosecution.

Forestalling Criminal Tax Fraud Prosecution. It is asserted that the problem of deductibility of attorneys' fees paid by a taxpayer to attorneys for representation in successfully preventing tax fraud criminal proceedings from being instituted is of great importance. The United States Supreme Court has never passed directly upon this vital question and it is respectfully submitted that the problem involves sufficient policy considerations to warrant the issuance of a Writ of Certiorari.

First, constitutional provisions demand that a criminally accused person have a right to counsel. *U. S. Constitution, Amendment VI.* It is not contended here that petitioners were deprived of counsel during the proceedings in issue. On the contrary, petitioners were well represented in both the civil and criminal aspects of the case. It is asserted, however, that the constitutional mandate of *Article VI* should not be functionally circumvented by a rule disallowing a taxpayer's deduction for fees paid to attorneys for successfully preventing criminal tax fraud indictment, prosecution or convic-

tion. In our self assessing tax system with its twenty to ninety-one percent income tax brackets, it is little comfort to a taxpayer administratively accused of tax fraud to know that he has a right to legal representation in our society but can hardly afford it under our system of taxation. See Circuit Judge Cameron's dissent in *Brinson v. Tomlinson,* 264 F.2d 30 at 37. (B. 7-15)

Secondly, a definitive decision is necessary in this area to guide taxpayers and revenue agents in the administration of the revenue system. The majority of the Court of Appeals stated:

> "The parties agreed that, 'A part of the services performed was in connection with the determination of the civil tax liability of the partnership and the partners,' but the stipulation is silent as to any allocation of the fee to such services. As to such part of the fee, therefore, the taxpayer failed to meet the burden of proving the amount to which he was entitled." [264 F.2d 39 at 33]. (B. 4)

Judge Cameron, dissenting, pointed out the practical difficulty of such allocation thusly:

> "Most of the time the appellants and their lawyers were talking with those engaged primarily in collection of taxes by civil means, activities were in process by those who prosecute for crime. *Who is there wise enough to separate the two*—to say which conference, which activity (short of grand jury indictment) belonged to the criminal side, which to the civil?" (264 F.2d 30 at 37) (B. 14-15) [Emphasis added].

If the rule espoused by the majority (requiring a dollar allocation of a fee between criminal and civil aspects of a tax case) be absurd, this Court should pre-

vent its further use. If the rule be just, this Court apparently is the body "wise enough to separate the two" and should set down standards to guide both revenue agents and taxpayers' attorneys in such an allocation.

Thirdly, since the Treasury's revocation of its policy of declining criminal prosecution of taxpayers who voluntarily disclose intentional violations of the *Internal Revenue Code* (S. 2930, dated January 1952, 525 CCH ¶ 6079), there has been a substantial trend toward attorneys representing taxpayer-clients in a joint civil-criminal manner similar to the facts of this case. Where this has been the situation or where there has been any suggestion of criminal tax fraud, the Commissioner has consistently contended that attorneys' fees paid for such legal representation were not deductible—e.g., *Brinson v. Tomlinson*, 264, F.2d 30 (5th Cir. 1959); *Acker v. Comm'r*, 258 F.2d 568 (6th Cir. 1958); *Comm'r v. Schwartz*, 232 F.2d 94 (5th Cir. 1956; *Hopkins v. Comm'r*, 30 T.C. 1015 (1958); *International Trading Co. v. Comm'r*. T.C. Memo. 1958-104. The growing incidence of this dual method of representation and the Commissioner's position of non-deductibility have caused clogging at administrative and court levels by the reinvestigation of old situations. Cases thought to have been concluded are resurrected and rehashed to determine the deductibility of fees paid to attorneys for representation in the original controversy. A definitive decision as to deductibility or nondeductibility is needed in this problem area to prevent waste to both taxpayers and governmental agencies administering the revenue.

Fourthly, it is submitted that this Court should reinvestigate its ruling in *Comm'r v. Heininger,* 320 U.S. 467, 64 S. Ct. 249 (1943) and either extend it or distinguish that decision from the factual setting presented by this case. In *Comm'r v. Heininger,* supra the taxpayer sought to deduct attorney's fees as ordinary and necessary business expenses. The taxpayer, through his attorney, had sought unsuccessfully to enjoin a Post Office fraud order issued to prevent the taxpayer from selling false teeth by various misrepresentations. This Court concluded that it must decide whether the legal expense was "ordinary" and "necessary" within the meaning of the deduction statute and concluded that it was "ordinary" and "necessary" and thus deductible. The subtle difference between the *Heininger* facts and the present case's facts is that in the former situation an administrative agency (the Post Office) assigned a fraudulent quality to the income producing conduct of the taxpayer. In the present case, the Treasury Department attributed a criminal character to the activities of the petitioners' partnership as regards the participation in profits by the government required by our internal revenue system. However, in both cases successful criminal prosecution likely would have caused the destruction of the income producing businesses themselves. See Judge Cameron's dissent in *Brinson v. Tomlinson,* 264 F.2d 30 at 37. (B. 7-15)

Whether the *Heininger* decision supports the petitioners' substantive position or is distinguishable on its facts is unimportant here. However, in light of the increased litigation regarding the deductibility of attorneys' fees in criminal tax fraud cases, this Court should take this opportunity to reinvestigate the *Heininger* doctrine and extend it, limit it or dispose of it with regards to the tax fraud setting to guide and assist the Courts, Treasury Department and taxpayers.

ARGUMENT

Procedural Law

The petitioners submit that The District Court below erred grievously in denying petitioners' motion to take testimony (R. 7) in supplementation of the Stipulation of Facts (R. 4-6) and contend that the denial of such motion was contrary to the Supreme Court's decision in *Carnegie Steel Co. v. Cambria Iron Co.*, 185 U.S. 403, 22 S.Ct. 698 (1901). It is further asserted that such denial in contrary to the spirit of the *Federal Rules of Civil Procedure*, particularly Rule 1, which states:

> ". . . They [the rules] shall be construed to secure the just, speedy, and inexpensive determination of every action."

In *Carnegie Steel Co. v. Cambria Iron Co.*, supra, this Court, favoring the repudiation of a stipulation inadvertently entered, said:

> "Stipulations are ordinarily entered into for the purpose of saving time, trouble or expense. . . . But while the stipulation is undoubtedly admissible in evidence it ought not to be used as a pitfall, and where the facts subsequently developed show, with respect to a particular matter that it was inadvertently signed, we think that upon giving notice of sufficient time to prevent prejudice to the opposite party, counsel may repudiate any fact inadvertently incorporated therein. This practice has been frequently upheld in this and other courts."

In the instant case, petitioners made no effort to repudiate a stipulation but merely desired to take testimony to supplement the stipulation by evidence consistent with it and inadvertently omitted . (R. 7). See Judge Cameron's dissent in *Brinson v. Tomlinson*, 264

F.2d 30 at 35. (B. 7-15) Add to such a situation the fact that the stipulation was entered into in the heat of trial (R. 9) and the motion was made shortly after the government refused to further stipulate. (R. 7, 11). It should be noted also that the motion preceded final argument and decision by eleven months and the entry of final judgment by thirteen months (R. 7, 12).

Although the antiquity (1901) of the *Carnegie Steel Co.* case, supra, may be called to the attention of this Court by counsel for the respondent, it is submitted that that decision is even more timely today than it was at the turn of the century because of the major advance in judicial procedure inaugurated by the liberal *Federal Rules of Civil Procedure.* Their intendment is to shake off the cumbersome inequitable procedural practices and provide for economical and speedy litigation. In the light of such changes, the *Carnegie Steel* case, supra, should be assigned substantial weight.

The decision of the District Court and its affirmation by the Court of Appeals denying a motion timely brought to take testimony in supplementation of the stipulation, assaults the senses of justice and fair play which characterize American jurisprudence. Thus, it is submitted that sufficient grounds exist regarding this procedural matter to justify this Court's issuing a Writ of Certiorari.

Respectfully submitted,

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Counsel for Petitioners

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CERTIFICATE OF SERVICE

It is hereby certified that service of copies of this Petition for Writ of Certiorari have been made on the Solicitor General, Department of Justice, Washington 25, D. C., and upon opposing counsel, by air mail, in accordance with Rule 33 (1) and (2) of the Supreme Court Rules.

Dated Day of , 1959.

Counsel for Petitioners

APPENDIX A

IN THE

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT FLORIDA

TAMPA DIVISION

CASE NO. 2877

S. B. BRINSON and LEOTA L. BRINSON

Plaintiffs

v

LAURIE W. TOMLINSON
Director of Internal Revenue
for the District of Florida

Defendant

(March 28, 1958)

Mabry, Reaves, Carlton, Anderson, Fields & Ward
—for Plaintiffs

Richard Kelly, Assistant United States Attorney
—for Defendant

FINDINGS OF FACT AND CONCLUSIONS OF LAW

WHITEHURST, District Judge:

There are three issues presented in this action.

The first issue is whether a note given by Brinson Construction Company, Incorporated, to Brinson Construction Company, a partnership, was a bona fide debt of the corporation.

The second issue is whether the gain realized on the sale of a building by Brinson Construction Company, a partnership, to Brinson Construction Company, Incorporated, was a long term capital gain or ordinary income to the partnership.

The third issue is whether the paymentof $22,920.10 by Brinson Construction Company, a partnership, as attorney fees, was an ordinary and necessary business expense of the partnership and deductible from gross income on the partnership's income tax return; or in the alternative, if it was not an ordinary and necessary business expense of the partnership, was it an ordinary and necessary non-business expense of the individual partners and deductible from gross income by each partner individually.

All remaining issues raised by the pleadings were conceded by plaintiffs.

FINDINGS OF FACT

Issue No. 1

The Court finds, on the verdict of a jury, that the note given by Brinson Construction Company, Incorporated, to Brinson Construction Company, a partnership, was a bona fide debt of the corporation.

Issue No. 2

The Court finds that the defendant conceded this issue, and therefore finds that the gain realized on the sale of the building by Brinson Construction Company, a partnership, to Brinson Construction Company, Incorporated, was long term capital gain.

Issue No. 3

The facts in this issue were stipulated and the Court finds that:

Early in 1950, the Brinson Construction Partnership, which at one time consisted of Charles Ebersbach, Theodore Ebersbach, S. B. Brinson and Chalmers M. Parker, came under investigation by the Intelligence Department of the Tampa Office of the Internal Revenue Service. The case was entitled in the file and upon the records of the Treasury Department as "Theodore Ebersbach, et al." There followed numerous conferences with the special agent in charge and other special agents, together with Internal Revenue Agents. These conferences were held in Tampa. From the inception of the investigation until final disposition of the case, the Brinson Construction Partnership and the Plaintiff, S. B. Brinson, were represented by the law office of Mabry, Reaves, Carlton, Anderson, Fields & Ward. During the course of the investigation, amended returns were prepared and filed on behalf of the partnership and the individual partners, and the taxes computed on the individual returns were paid. No penalties, however, were paid at that time.

Chalmers M. Parker, one of the two remaining partners, appeared before the special agent in charge on two occasions, and the Plaintiff, S. B. Brinson, upon

one occasion. Additional conferences were held with the Intelligence Unit where questions were propounded of the partnership's bookkeeper and one of the partnership's foremen.

On October 6, 1950, the local Intelligence Unit of the Internal Revenue Service advised the partners that criminal prosecution had been recommended for the year 1944. A conference was granted by the Penal Division of the Treasury Department in Atlanta which was attended by the partners, S. B. Brinson and Chalmers M. Parker, with their attorneys. Following this conference in November, 1950, the partners were notified that the Penal Division had recommended criminal prosecution. During the month of November, 1950, amended returns were filed on behalf of the Brinson Construction Partnership, S. B. Brinson, and Chalmers M. Parker, and the tax computed thereon was paid.

Subsequent conferences were held with Treasury Department Officials in Washington, and on November 12, 1950, the case was forwarded to the Justice Department recommending criminal prosecution.

After the case was forwarded to the Department of Justice, additional conferences were held and the partners were notified that criminal prosecution had been authorized against S. B. Brinson. On January 12, 1951, charges were filed and warrant issued against S. B. Brinson by U. S. Commissioner for the Southern District of Florida.

During April of 1951, it was suggested by Counsel for Plaintiff S. B. Brinson, that he was not in sufficiently good health to stand trial. This was supported by a letter from Taxpayer's physician stating that he was suffering from high blood pressure and a heart condition.

On April 27, 1951, Taxpayer suffered a heart attack which required hospitalization. Due to Taxpayer's ill health, and in conformance with Justice Department policy to decline prosecution in a case in which the health of the Taxpayer would be endangered by standing trial, it was decided on September 5, 1951, to decline prosecution and, on October 3, 1951, the charges were withdrawn. No indictment was returned against the partnership nor against either partner.

After the criminal features of the case were concluded, a determination was made as to Plaintiff's civil liability for the years 1943 through 1947, inclusive, and a final settlement was made on the basis of the deficiency determined by the Government, interest, and the 50% fraud penalty.

A part of the work done and services rendered by the law firm of Mabry, Reaves, Carlton, Anderson, Fields & Ward throughout the period covered by this Stipulation was devoted to presentation to the Government of the reasons and arguments which, in the opinion of the Taxpayer, would justify the Government's declining to commence criminal proceedings against Chalmers M. Parker and the Plaintiff S. B. Brinson. A part of the services performed was in connection with the determination of the civil tax liability of the partnership and the partners. The law firm charged a fee of $22,500.00 which was paid by the partnership and deducted on its 1951 income tax return. This deduction was disallowed by the Commissioner which resulted in an increase of $22,500.00 in the partnership's taxable income, and an increase of $11,250.00 in Plaintiff's taxable income.

CONCLUSIONS OF LAW

Issue No. 1

Since it has been determined that the note given by Brinson Construction Company, Incorporated, to Brinson Construction Company, a partnership, was a bona fide debt of the corporation, plaintiffs are entitled to judgment on this issue.

Issue No. 2

Since the defendant concedes this issue, the plaintiffs are entitled to judgment on the issue.

Issue No. 3

The Court concludes that the payment of $22,920.10 by Brinson Construction Company, a partnership, as attorney fees was not an ordinary and necessary business expense of the partnership and was not deductible from gross income on the partnership's return of income; the Court further concludes that such payment of attorney fees was not an ordinary and necessary non-business expense of the individual partners and was not deductible from gross income by each partner individually and that therefore defendant is entitled to judgment on this issue.

Judgment will be entered for defendant dismissing plaintiffs' action on issue Number 3.

Judgment will be entered for plaintiffs on issues Number 1 and Number 2 in such amounts as shown by recomputation agreed to by counsel for the parties are due.

APPENDIX B

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 17399

S. B. BRINSON and LEOTA L. BRINSON,

Appellants,

versus

LAURIE W. TOMLINSON, Director of Internal Revenue for the District of Florida,

Appellee.

Appeal from the United States District Court for the Southern District of Florida.

(February 26, 1959.)

Before RIVES, TUTTLE and CAMERON, Circuit Judges

RIVES, Circuit Judge: This appeal concerns a claimed overpayment of income tax for the year 1952, arising out of the disallowance of a deduction of an attorney's fee paid by a partnership of which the taxpayer, S. B. Brinson, was a member. The district court adopted as its findings of fact a stipulation entered into between the

parties.[1] Upon those facts, the court made conclusions

[1] "Early in 1950, the Brinson Construction Partnership, which at one time consisted of Charles Ebersbach, Theodore Ebersbach, S. B. Brinson and Chalmers M. Parker, came under investigation by the Intelligence Department of the Tampa Office of the Internal Revenue Service. The case was entitled in the file and upon the records of the Treasury Department as 'Theodore Ebersbach, et al.' There followed numerous conferences with the special agent in charge and other special agents, together with Internal Revenue Agents. These conferences were held in Tampa. From the inception of the investigation until final disposition of the case, the Brinson Construction Partnership and the Plaintiff, S. B. Brinson, were represented by the law office of Mabry, Reaves, Carlton, Anderson, Fields & Ward. During the course of the investigation, amended returns were prepared and filed on behalf of the partnership and the individual partners, and the taxes computed on the individual returns were paid. No penalties, however, were paid at that time.

"Chalmers M. Parker, one of the two remaining partners, appeared before the special agent in charge on two occasions, and the Plaintiff, S. B. Brinson, upon one occasion. Additional conferences were held with the Intelligence Unit where questions were propounded of the partnership's bookkeeper and one of the partnership's foremen.

"On October 6, 1950, the local Intelligence Unit of the Internal Revenue Service advised the partners that criminal prosecution had been recommended for the year 1944. A conference was granted by the Penal Division of the Treasury Department in Atlanta which was attended by the partners, S. B. Brinson and Chalmers M. Parker, with their attorneys. Following this conference in November, 1950, the partners were notified that the Penal Division had recommended criminal prosecution. During the month of November, 1950, amended returns were filed on behalf of the Brinson Construction Partnership, S. B. Brinson, and Chalmers M. Parker, and the tax computed thereon was paid.

"Subsequent conferences were held with Treasury Department Officials in Washington, and on December 12, 1950, the case was forwarded to the Justice Department recommending criminal prosecution.

"After the case was forwarded to the Department of Justice, additional conferences were held and the partners were notified that criminal prosecution had been authorized against S. B. Brinson. On January 12, 1951, charges were filed and warrant issued against S. B. Brinson by U.S. Commissioner for the Southern District of Florida."

of law adverse to the taxpayer.[2]

The questions presented on appeal are whether the district court erred in holding that the attorney's fee was

"During April of 1951, it was suggested by Counsel for Plaintiff S. B. Brinson, that he was not in sufficiently good health to stand trial. This was supported by a letter from Taxpayer's physician stating that he was suffering from high blood pressure and a heart condition.

"On April 27, 1951, Taxpayer suffered a heart attack which required his hospitalization. Due to Taxpayer's ill health, and in conformance with Justice Department policy to decline prosecution in a case in which the health of the Taxpayer would be endangered by standing trial, it was decided on September 5, 1951, to decline prosecution and, on October 3, 1951, the charges were withdrawn. No indictment was returned against the partnership nor against either partner.

"After the criminal features of the case were concluded, a determination was made as to Plaintiff's civil liability for the years 1943 through 1947 inclusive, and a final settlement was made on the basis of the deficiency determined by the Government, interest, and the 50% fraud penalty.

"A part of the work done and services rendered by the law firm of Mabry, Reaves, Carlton, Anderson, Fields & Ward throughout the period covered by this Stipulation was devoted to presentation to the Government of the reasons and arguments which, in the opinion of the Taxpayer, would justify the Government's declining to commence criminal proceedings against Chalmers M. Parker and the Plaintiff, S. B. Brinson. A part of the services performed was in connection with the determination of the civil tax liability of the partnership and the partners. The law firm charged a fee of $22,500.00 which was paid by the partnership and deducted on its 1951 income tax return. This deduction was disallowed by the Commissioner which resulted in an increase of $22,500.00 in the partnership's taxable income, and an increase of $11,250.00 in Plaintiffs' taxable income."

[2] "The Court concludes that the payment of $22,920.10 by Brinson Construction Company, a partnership, as attorney fees was not an ordinary and necessary business expense of the partnership and was not deductible from gross income on the partnership's return of income; the Court further concludes that such payment of attorney fees was not an ordinary and necessary non-business expense of the individual partners and was not deductible from gross income by each partner individually and that therefore defendant is entitled to judgment on this issue."

neither deductible by the partnership as an ordinary and necessary expense of its construction business, within the meaning of Section 23 (a) (1) (A) of the 1939 Code, nor by the taxpayer as a non-business expense, within the meaning of Section 23 (a) (2) of the Code,[3] and whether the district court erred in denying the plaintiffs' motion for leave to offer testimony to supplement the stipulation of facts.

The parties agreed that, "A part of the services performed was in connection with the determination of the civil tax liability of the partnership and the partners," but the stipulation is silent as to any allocation of the fee to such services. As to such part of the fee, therefore, the taxpayer failed to meet the burden of proving the amount to which he was entitled.[4]

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[3] Internal Revenue Code of 1939:

"§23. *Deductions from Gross Income.*

"In computing net income there shall be allowed as deductions:

"(a) [As amended by Sec. 121 (a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

"(1) *Trade or Business Expenses.*—

"(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; . . . .

". . . .

"(2) *Non-Trade or Non-Business Expenses.* — In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

". . . ."

26 U.S.C.A., 1952 ed., Sec. 23.

[4] Burnet v. Houston, 1931, 283 U.S. 223, 227; New Colonial Co. v. Helvering, 1934, 292 U.S. 435, 440; Helvering v. Taylor, 1935, 293 U.S. 507, 515.

The other part of the lawyers' work and services was to forestall criminal prosecution of the taxpayer and of Chalmers M. Parker, his partner. The stipulation was silent as to the nature of the alleged criminal activities and their relationship, if any, to the business of the partnership. The stipulation failed to show that the attorney's fee was an ordinary and necessary expense of the partnership business within Section 23 (a) (1) (A), or a non-business expense of the taxpayer for the production or collection of income or for any other purpose listed in Section 23 (a) (2). We do not, therefore, reach the question of whether an attorney's fee expended to forestall criminal prosecution may, under circumstances not here proved or stipulated, be allowed as a deduction under either of those provisions.[5]

At the time the stipulation was agreed on, February 6, 1957, two other issues were in dispute between the parties. On one of those, the "Debt Issue," the case was tried before a jury on the same day and the jury returned its verdict in favor of the plaintiffs. Later the Government conceded the other issue, the "Building Sales Issue." Later still, after the "Attorney's Fee Issue" had been submitted to the court on the stipulation of facts and a brief filed on behalf of the Director, the plaintiffs proposed a supplemental stipulation to provide as follows: "All of the fraudulent acts of which plaintiff, S. B. Brinson, was accused arose out of the business activities of the partnership."

[5] See Commissioner v. Heininger, 1943, 320 U.S. 467, 471; Commissioner v. People's Pittsburgh Trust Co., 3rd Cir. 1932, 60 F. 2d 187, 189; Commissioner of Internal Revenue v. Schwartz, 5th Cir. 1956, 232 F. 2d 94.

The Director refused to enter into the supplemental stipulation. The plaintiffs then, on April 30, 1957, moved the court to permit the taking of testimony to establish that the fraudulent acts of which S. B. Brinson was accused arose out of the business activities of the partnership. The Director opposed said motion "unless the verdict of the jury, returned on February 6, 1957, be set aside and the entire case set down for retrial." On May 9, 1957, after hearing argument of counsel, the district court denied the motion for leave to take testimony.

The stipulation was entered into at the suggestion of the plaintiffs' attorney. Most of the terms of the stipulation were suggested by that attorney. Its provisions were carefully considered on each side before agreement was reached. There was no claim that anything had been inadvertently included in the stipulation, or that any overreaching or fraud was involved. One of the issues had then been conceded by the Government and a second issue decided by a jury in favor of the plaintiffs. The plaintiffs were not willing to have the verdict set aside and the entire case set down for re-trial so as to restore both sides to the position they were in before the stipulation was agreed on. Justice sometimes requires that stipulations made under misapprehension or without full knowledge of all the facts, or as the result of mistake, be set aside.[6] This is not such a case, and the district court did not abuse its discretion in denying the motion to permit the taking of testimony to supplement the stipulation.

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[6] Carnegie Steel Co. v. Cambria Iron Co., 1902, 185 U.S. 403, 414; Aronstam v. All-Russian Cent. U. of Consumers' Soc., 2nd Cir. 1920, 270 Fed. 460, 464; Russell-Miller Milling Co. v. Todd, 5th Cir. 1952, 198 F. 2d 166, 169.

The judgment is therefore

AFFIRMED.

CAMERON, Circuit Judge, Dissenting:

I am unable to agree with the majority opinion that the trial court did not commit reversible error in concluding that the $22,920.10 paid by the partnership was not a deductible expense and in refusing to permit appellants, upon timely motion, to make proof that "all of the fraudulent acts of which plaintiff, S. B. Brinson, was accused arose out of the business activities of the partnership." The only thing involved in the hearing before the court at that time was whether appellants were entitled to recover the $22,920.10 they had paid out to their attorneys. The Director opposed the granting of the motion, and the court below denied it and, for failure of proof concerning the attorneys' fee, entered judgment against appellants.

I.

Examining the record before us first without the proffered supplemental proof, it is plain that there was no real issue between the parties as to whether the acts of fraud charged against Brinson were acts performed in the partnership business. The record shows undisputedly that the partnership paid the attorneys' fees and included the item as a deduction on the partnership return. The Commissioner disallowed the item in his examination of the partnership return. The stipulation

shows: "Early in 1950, the Brinson Construction Partnership, which at one time consisted of Charles Ebersbach, Theodore Ebersbach, S. B. Brinson and Chalmers M. Parker, came under investigation by the Intelligence Department of the Tampa Office of the Internal Revenue Service. The case was entitled in the file and upon the records of the Treasury Department as 'Theodore Ebersbach, et al.'"

It was further stipulated that, October 6, 1950, the local Intelligence Unit "advised the partners that criminal prosecution had been recommended . . ." Following several conferences "the partners were notified that the Penal Division had recommended criminal prosecution." Thereafter Brinson Construction Partnership filed amended returns and additional taxes were paid. Later, the Department of Justice considered the case "and the partners were notified that criminal prosecution had been authorized against S. B. Brinson."

We find no contention in the Government's brief that the fraudulent acts alleged against Brinson were not solely in connection with the business activities of the partnership. On the other hand in defining the two questions presented by the appeal the Government mentioned only the criminal prosecution feature and the court's action in refusing to permit the supplemental proof to be offered.

The farthest position taken by the Govenment in its argument is that the evidence is silent as to the precise nature of the alleged criminal activities, but the record does show that it was the activities of the partners in

their construction business which lay at the base of the accusations. Under the circumstances, I do not think that the lower court had any right to assume, in the face of what did appear in the record, that the tax authorities were pursuing the members of the partnership for activities unrelated to the partnership business. I think, therefore, that the record and the briefs of the parties show that all parties recognized that the fraudulent acts of which Brinson was accused were committed in connection with the business activities of the partnership; and that we must, in any event, decide the case on the merits.

II

The motion for leave to supplement the stipulation so as to remove all doubt about that question ought, moreover, in my opinion, to have been granted. Neither the affidavit opposing the motion for leave to introduce this proof nor the Director's brief points out that any injustice would result if the appellants were granted leave to make the proof. The motion set up, and nobody denied, that appellants' attorney had failed to include this in the stipulation "through oversight." The motion was filed on April 30, 1957; it was denied on May 9th; and final order was entered on May 21st.

The stipulation did not recite that it contained all of the facts, or that it was not to be supplemented by proof. The Supreme Court had before it a stipulation not unlike this in *Carnegie Steel Co. v. Cambria Iron Co.*, 185 U.S. 403, when it said: "Stipulations are ordinarily

entered into for the purpose of saving time, trouble or expense . . . But while the stipulation is undoubtedly admissible in evidence it ought not to be used as a pitfall, and . . . we think that upon giving notice in sufficient time to prevent prejudice to the opposite party, counsel may repudiate any fact inadvertently incorporated therein." And see the decision of this Court in *Russell-Miller Milling Co. v. Todd,* 1952, 198 F.2d 166.

In that case counsel was permitted to repudiate one of the statements in the stipulation. Here, counsel seeks only to supplement the stipulation by evidence consistent with it and which was inadvertently omitted. As I read the record and the briefs, no advantage would have been gained by appellants and no loss would have accrued to appellee beyond the work which would have been entailed by supplementing the briefs already filed before the court. I think that the genius of the Federal Rules of Civil Procedure would be frustrated by approving the holding of the lower court; and that this Court has said so in graphic words, *Alabama Great Southern Railroad Co., et al v. Johnson, et al,* 1944, 140 F.2d 968, 972. In that case, the attorneys for the Railroad Company had requested a charge which the court embraced in its general charge and the same attorneys nevertheless objected to it when the opportunity was given them before the jury retired. The court below refused to change its charge because it had been led to make it by a portion of a refused charge requested by the Railroad's attorneys. This Court reversed, using this language:

> ". . . Even if defendants' instruction 'E', which contained the complained of language, had been

> marked 'given' instead of 'refused', and had been given exactly as the defendants had requested it, defendants could have timely pointed out and confessed the error in their own charge and obtained a proper instruction effecting its cure. . . . . The Federal rules, by aiding in converting a lawsuit from a battle of wits and a succession of traps and pitfalls into a calm and ordered procedure for the discovery of truth, were designed for the purpose of avoiding the very situation which this case presents, *the loss of rights, the prevention of justice, through errors which, by timely request for correction, are called to the attention of the court.* . . . Rules which were adopted with the express purpose of relieving litigants from traps and pitfalls and procrustean rulings or results may not be applied, as they have been here, to produce them." [Emphasis supplied.]

III.

The stipulation admitted that "A part of the services performed was in connection with the determination of the civil tax liability of the partnership and the partners." The Director's argument against allowance of the fee is thus epitomized:

> "...Nor were any facts stipulated from which the District Court could possibly have determined what part of the fee was paid for the determination of civil liability, and what part for representation to forestall criminal prosecution. . . . As to legal expense incurred in connection with the determination of civil liability,

there was a failure of proof on the taxpayer's part with respect to this aspect of the case, and the District Court was therefore correct in disallowing the claimed deduction of the $22,500 fee in its entirety."

The failure of proof urged by the Government, therefore, is not failure to prove that the money was spent in connection with the partnership's business, but failure to prove the dollars and cents allocable to the civil portion of the tax and penalties. Consider also its further argument: "In the instant case the payment of the attorney's fee to forestall criminal tax charges against the taxpayer was not a business expense within the meaning of Section 23(a)(1)(A), but a 'personal expense,' because . . . the crime charged is necessarily a personal crime and the defense cannot in the nature of things be a matter of business; . . ." The authority upon which the Government relies to support this thesis, besides a decision of the Tax Court and one of the Court of Claims, is the dissenting opinion of Judge Rives in our case of *Commissioner v. Schwartz,* 232 F.2d 94.

The majority finds it unnecessary to decide whether attorneys' fees paid to forestall criminal prosecution against the partners would be a deductible expense. Assuming what is not controverted in the record or the Government's brief, that the threatened criminal prosecution involved only matters arising from the partnership business, I think that the entire attorney's fee would be deductible and that we ought to hold that this is true. Such is, in my opinion, the effect of our holding

in *Schwartz, supra,* 232 F.2d at p. 101,[1] no criminal prosecution having been instituted in the case before us.

In the age-old struggle between organized society and the individual this nation[2] has achieved a fair measure of balance. In no field of that relationship, it seems probable, does the Government possess such a downhill pull as in the enforcement of the federal income tax laws. Starting with the unparalleled premise that the Government's claim extends to every dollar of the taxpayer's income from whatever source derived, and that what he is able to save for his own uses by way of deductions, exemptions, and the like comes to him only as a matter of grace, the taxpayer is engaged in an uphill fight all the way.

Any assessment made by the Commissioner,[3] however fantastic it may be, travels always upon a presumption

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1 The annotator in A.L.R. 2d Series Supplement Service, 1948-1957, page 1584, thus sums up the holding of that case:

"The Supreme Court tends to restrict the violations of public policy which will support a disallowance of deductions. Denial of deduction for attorney fees is limited to services in unsuccessful defense of criminal prosecution and does not extend to services in matter out of which a criminal charge may possibly arise. Comr. v. Schwartz (CA 5th) 232 F2d 94, affg 22 T Ct 717, holding public policy not violated in allowing deduction of fees for services in setting liability for income tax and civil fraud penalties although taxpayer was subsequently indicted and convicted of fraud."

The Supreme Court has never intimated that a business connected expense was not deductible because those by whom it was paid, presumed to be innocent, were charged with criminal violations. Cf. Lilly v. Commissioner, 4 Cir., 1951, 188 F.2d 269, reversed 343 U.S. 90, and Commissioner v. Heininger, 1943, 320 U.S. 467.

2 As pointed out by Mr. Justice Jackson in "The Supreme Court in the American System of Government," page 75 et seq.

3 In most cases, a euphemistic term employed to describe a lowly functionary in the field, or a coterie of them, struggling for advancement by producing income for the exchequer.

of correctness. Largely, he makes his own rules through the issuance of regulations having the force of law. He can compel the taxpayer and all with whom he deals to come before him or his agents and testify under oath and bring all their books and records. He can levy against the taxpayer heavy civil penalties for failure to file his return or tardiness therein, or underestimating or fraudulently concealing his income. He can shackle the taxpayer to a point of helplessness by jeopardy assessments and warrants of distraint.

When the Commissioner (or his representatives) chooses to go into litigation he has the advantage of formulae built upon circumstantial evidence worked out by experts, such as the net worth method, which impose an additional exceedingly heavy burden upon the taxpayer. He claims and practices the right[4] to avail himself, in any proceeding before a jury, of examination of the income tax returns of all prospective jurors.

Lurking necessarily in the background of many tax investigations is the ominous suggestion of possible criminal prosecution. In a close case it is inevitable that somewhere along the line the unit which develops criminal cases gets involved in the investigation. The matter before us furnishes a typical illustration of proceedings in such a case. Most of the time the appellants and their lawyers were talking with those engaged primarily in collection of taxes by civil means, activities were in progress by those who prosecute for crime. Who

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[4] See Treasury Regulation 26 C. F. R., §458.32 and United States v. Costello, 2 Cir., 1958, 255 F.2d 876, 882-883, certiorari denied 357 U.S. 937. And cf. No. 17259, Court of Appeals, Fifth Circuit, Edgar Martin v. United States.

is there wise enough to separate the two—to say which conference, which activity (short of grand jury indictment) belonged to the criminal side, which to the civil?

Surely taxpayers are entitled to the assistance of lawyers and other experts. Faced by probably the greatest galaxy of such experts ever assembled in this country, it certainly is not the policy of the law to discourage the employment of lawyers by the taxpayer. That is what these appellants did. From the beginning of the investigation to this day, they are presumed to be innocent of any crime. The proffered proof would have established beyond question what already fairly appears in the record—that every service the lawyers performed was business connected. It is admitted that part of their services had to do with civil matters alone. Surely the rudiments of fair play, as well as the law, condemn a course which cannot but discourage taxpayers in availing themselves of the services of lawyers. Those employed in this case were entitled to be paid for all of the services rendered, and to be paid by the business, which would probably have been crippled or destroyed without their assistance. I think the *Schwartz* case and the cases there cited stand for this principle and that we should, by following it, avoid lengthening the rope or steepening the slope. I think the court below should have permitted the proffered proof so that its decision would have been based upon all of the facts; and that, without this proof, it should have found for the appellants on the record before it.

I respectfully dissent.

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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 226

S. B. BRINSON AND LEOTA L. BRINSON, PETITIONERS

v.

LAURIE W. TOMLINSON, Director of Internal Revenue for the District of Florida

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (Pet. A-2—A-6) are not officially reported. The opinion of the Court of Appeals (Pet. B-1 - B-5) is reported at 264 F. 2d 30.

JURISDICTION

The judgment of the Court of Appeals was entered on February 26, 1959 (Pet. B-1), and a petition for rehearing was denied on April 22, 1959.

The petition for certiorari was filed on July 18, 1959. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether the record sustains the findings below that the payment by a partnership of legal fees for services rendered to the individual partners was neither an ordinary and necessary business expense of the partnership nor an ordinary and necessary non-business expense of the taxpayer who was one of the partners.

2. Whether the Court of Appeals correctly held that, in the circumstances of this case, the District Court did not abuse its discretion in refusing to grant a retrial and to permit the taxpayer to offer testimony to supplement a stipulation of facts.

STATUTE AND REGULATIONS INVOLVED

Section 23(a)(1)(A) and (2) of the Internal Revenue Code of 1939 and Sections 29.23(a)-1 and 29.23(a)-15 of Treasury Regulations 111 are set forth in the Appendix, *infra*, pp. 10-14.

STATEMENT

The facts, as stipulated, and as adopted and found by the District Court (Pet. A-2—A-6), may be summarized as follows:

In 1950, the Brinson Construction Partnership and its partners, including the taxpayer,[1] were investi-

[1] S. B. Brinson is referred to as the taxpayer since only his activities are in issue and his wife, Leota, is a party only because they filed joint individual income tax returns. (R. 1.)

gated by the local Intelligence Unit of the Internal Revenue Service. Special agents as well as Internal Revenue agents participated in the investigation. Subsequently, the case was forwarded to the Department of Justice and criminal prosecution was authorized by that Department against the taxpayer only. (Pet. A-3—A-4.)

On January 12, 1951, charges were filed and a warrant was issued against the taxpayer by the United States Commissioner for the Southern District of Florida. (Pet. A-4.) However, due to the taxpayer's ill health, and in acordance with the then extant Justice Department policy to decline prosecution in a case where a taxpayer's health would be endangered by standing trial, it was decided to decline prosecution, and, on October 3, 1951, the charges were withdrawn. (Pet. A-5.)

After the criminal features of the case were concluded, a settlement was made with the taxpayer with respect to his civil liability for deficiencies in tax and penalties for the years 1943 through 1947. (Pet. A-5.)

A law firm represented the partners with respect to their criminal liabilities, and also represented both the partnership and the partners with respect to their civil liabilities. The law firm charged a fee of $22,500, which was paid by the partnership and deducted by it on its 1951 tax return.[2] The Government disallowed the deduction, which resulted in an increase

[2] This was an information return.

of $22,500 in the partnership's taxable income, and an increase of $11,250 in the taxpayer's taxable income. (Pet. A-5.)

The attorneys' fee issue was submitted by the parties to the District Court on a stipulation of facts; another issue, concerning a debt, was submitted by the parties at the same time to a jury. After the jury decided the debt issue against the Government, and after the attorneys' fee issue was briefed, the taxpayer moved the court to permit the taking of testimony on the latter issue. The District Court denied the motion. (Pet. B-5—B-6.)

The District Court found that the payment by the partnership of the attorneys' fee was not an ordinary and necessary expense of the partnership business and that it was therefore not a deductible item on the partnership return. It also found that such payment was not an ordinary and necessary non-business expense of the taxpayer and was therefore not deductible from gross income on his tax return. (Pet. A-6.) The Court of Appeals affirmed, one judge dissenting. (Pet. B-1—B-15.)

ARGUMENT

The decision of the court below is correct, there are no conflicting decisions, and further review is not warranted.

1. Both courts below correctly concluded on the record here that a payment for attorneys' fees, by a partnership of which the taxpayer was a member, for legal services rendered in part to forestall the taxpayer's criminal prosecution on tax evasion

charges, was not an allowable deduction either as a business expense of the partnership or as a non-business expense of the taxpayer. In order to qualify as a partnership business deduction under Section 23(a)(1)(A) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 10), an expenditure must be both "ordinary and necessary". *Deputy* v. *duPont*, 308 U.S. 488. Mere proof of the payment of an expense will not suffice; it must also be shown that the obligation to pay arose out of a transaction customary in the type of business involved (i.e., ordinary), and that it was necessary to make the expenditure. *Commissioner* v. *Heininger*, 320 U.S. 467, 470. Similarly, under 1939 Code, Section 23(a)(2) (Appendix, *infra*, p. 10)—permitting deduction for an expense relating to the production or collection of income, or the management or conservation of property held for the production of income—the expense must also be "ordinary and necessary". *Trust of Bingham* v. *Commissioner*, 325 U.S. 365, 374; see also, *Lykes* v. *United States*, 343 U.S. 118, 123.

The Court of Appeals (Pet. B-5), as did the District Court (Pet. A-6), held that the taxpayer failed to show that the part of the attorneys' fees paid for services rendered in forestalling criminal prosecution of the taxpayer was an expenditure falling into either of the above two categories.[3] The stipulation, which

[3] In unwarrantedly assuming the existence of certain facts in the record, the dissenting opinion below (Pet. B-7—B-15) fails to recognize that the taxpayer had the burden of proving that the expenditure in question qualified as a deduction either under Section 23(a)(1)(A) or 23(a)(2). While it is true that criminal prosecution may result in fine or

comprises all the facts of record in this case, did not indicate with any specificity the nature of the alleged criminal activity. For example, the stipulation did not indicate whether criminal activity involved the falsification of the taxpayer's individual return, or the falsification of the partnership return, or both. It did not disclose the taxpayer's business or income-producing activities during the relevant period in which the alleged criminal acts were committed; nor did it otherwise disclose any facts indicating that the fee expenditure in question was ordinary and necessary, partnership-wise, or that it qualified as a non-business expenditure, taxpayer-wise. (Pet. B-2—B-3, B-5.) In short, the stipulation failed to disclose that the alleged criminal acts were anything other than purely personal in nature.

It is apparent, therefore, contrary to the taxpayer's contention (Pet. 12-15), that this case does not project the general question whether an attorney's fee expended to forestall criminal prosecution is deductible under Section 23(a)(1)(A) and (2). As the Court of Appeals stated (Pet. B-5):

> We do not * * * reach the question of whether an attorney's fee expended to forestall criminal prosecution may, *under circumstances not here proved or stipulated*, be allowed as a deduction under either of those provisions. (Emphasis supplied.)

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imprisonment and hence, in economic loss to a taxpayer, such incidental consequences do not alone bring the expense of forestalling criminal prosecution within the ambit of Section 23(a)(2). *Lykes* v. *United States*, 343 U.S. 118, 126; *Port* v. *United States*, 163 F. Supp. 645, 647 (C. Cls.).

The taxpayer's contention (Pet. 13-14) that the court below erred in not allowing as a deduction the part of the attorney's fee which was paid for legal services relating to civil income tax liability is likewise without merit. Although such expenses are concededly deductible, if proved,[4] the Court of Appeals properly held that "As to such part of the fee, * * * the taxpayer failed to meet the burden of proving the amount to which he was entitled." (Pet. B-4.) See *Burnet* v. *Houston*, 283 U.S. 223, 227; *New Colonial Co.* v. *Helvering*, 292 U.S. 435, 440; *Nowland* v. *Commissioner*, 244 F. 2d 450, 454 (C.A. 4th); *Harden M. Loan Co.* v. *Commissioner*, 137 F. 2d 282, 284 (C.A. 10th), certiorari denied, 320 U.S. 791.

2. Contrary to the taxpayer's contention (Pet. 16-17), the trial court's denial of the motion to permit the taking of testimony to supplement the stipulation entered into between the parties involved no abuse of discretion or contravention of the federal rule calling for a just, speedy, and inexpensive determination of the case. The stipulation was correctly characterized by the Court of Appeals as a "carefully considered" one, entered into "at the suggestion of the plaintiff's attorney", with no "overreaching or

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[4] Legal expenses incurred in the determination of liability for taxes upon *income* are deductible. However, expenses incurred by an individual in contesting other liabilities (for example, gift taxes) are not deductible merely by reason of the fact that income-producing property held by the taxpayer may be used for the purpose of satisfying such liability. *Lykes* v. *United States*, 343 U.S. 118; Treasury Regulations 111, Section 29.23(a)-15 (Appendix, *infra*, pp. 11-13). And see fn. 3, pp. 5-6.

fraud," with not even a remote suggestion that it had been entered into "under misapprehension or without full knowledge of all the facts, or as the result of mistake." (Pet. B-6.) In the circumstances, the refusal to permit the stipulation to be supplemented (to afford the taxpayer an unwarranted opportunity to cure the fatal defect in his proof) was consistent with this Court's decision in *Carnegie Steel Co.* v. *Cambria Iron Co.*, 185 U.S. 403. See also *Aronstam* v. *All-Russian Cent. U. of Consumers' Soc.*, 270 Fed. 460, 464 (C.A. 2d); *Russell-Miller Milling Co.* v. *Todd*, 198 F. 2d 166, 168-169 (C.A. 5th). Moreover, the motion (in effect for a new trial) was made almost three months after the case had been tried, and, as the Court of Appeals observed (Pet. B-6), the taxpayer, as a condition precedent to the granting of the motion, was not even "willing to have the verdict set aside * * * so as to restore both sides to the position they were in before the stipulation was agreed on."[5]

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[5] At the time the parties agreed to the stipulation (February 6, 1957) two issues other than the attorneys' fee issue were in dispute. The "Debt Issue" was tried before a jury, and the jury returned a verdict thereon in favor of the taxpayer. Later, the Government conceded the other issue, the "Building Sales Issue." (Pet. B-5.)

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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AUGUST, 1959.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * *

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance

of property held for the production of income.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23a)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23(a)-1. *Business Expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23(b) to 23(z), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. As to charitable contributions by corporations not deductible under section 23(a), see section 29.23(a)-13. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See section 29.22(a)-5.) Among the items included in business expenses are management expenses, commissions (but see section 29.24-2), labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see section 29.23(a)-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. Penalty payments with respect to Federal taxes,

whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. As to items not deductible under any provision of section 23, see section 24.

SEC. 29.23(a)-15. *Nontrade or Nonbusiness Expenses.—(a) In general.*—Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a)(2) only upon the condition that:

> (1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and
>
> (2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23(a)(2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * *

Expenses, to be deductible under section 23(a)(2), must be "ordinary and necessary," which

presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) [As amended by T. D. 5513, 1946-1 Cum. Bull. 61] Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23(a)(1)(A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. * * *

* * * *

* * *. Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such

tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income.

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